Testimony before the

House Foreign Affairs Committee

Subcommittee on Asia, the Pacific, Central Asia, and Nonproliferation

Hearing on

"Strategic Importance of Digital Economic Engagement in the Indo-Pacific"

Testimony by Wendy Cutler

Former Acting Deputy U.S. Trade Representative

January 19, 2022

Chairman Bera, Ranking Member Chabot, distinguished members of the Subcommittee, thank you for the opportunity to appear before you today to share my thoughts on the importance of a bold and impactful U.S. economic agenda for the Indo-Pacific region, with a digital economy component as its centerpiece.

No one understands better than this Subcommittee the geopolitical and economic significance of the Indo-Pacific region. As Secretary Blinken recently remarked, "The Indo-Pacific will, more than any other region, shape the trajectory of the world in the 21st century."

The Indo-Pacific is home to some of the largest, most dynamic and fastest-growing economies in the world. The region accounts for over 60 percent of global GDP and over one-third of global goods trade, up from 25 percent a decade ago. For the United States this means two-way trade with the region of over $1.75 trillion, making it the destination for nearly one-third of U.S. exports and supporting over 3 million American jobs. As we look ahead, the Indo-Pacific is poised to be the powerhouse of economic growth and innovation for years to come. Between 2019 and 2050, over half of global growth is expected to come from this region. Moreover, the region is projected to account for the majority of the global middle class by mid-century, making it a significant driver of future demand for goods and services.

The United States must strengthen its economic engagement in the Indo-Pacific. Given the trajectory of regional economic growth and innovation, U.S. economic prosperity will be closely tied to the region for the years to come. Without a robust regional economic agenda, the United States risks foregoing economic opportunities and becoming increasingly marginalized as the region forges a new future without us. As the global economy's center of gravity shifts towards the Indo-Pacific, the rules of regional economic engagement will help shape global rules and norms, whether or not we help to craft them.

Furthermore, robust economic engagement is also essential to restore U.S. credibility and influence in the Indo-Pacific. Security partnerships alone will not achieve that. Our regional partners are looking to the United States to offer a constructive and credible economic vision. It is therefore encouraging that the Administration is now developing a new Indo-Pacific Economic Framework (IPEF) to be launched early this year.

THE CHANGING INDO-PACIFIC TRADE LANDSCAPE

Since the United States exited the TPP, our regional partners have not slowed down in their quest for open markets and new economic opportunities. They view trade expansion as an essential path to promote economic growth, create jobs, and improve livelihoods for their citizens. The fact that two mega-regional trade deals have now entered into force over the past three years without the United States is stunning in light of where these countries were only a decade ago. It should serve as a wake-up call for the United States. No longer are our partners waiting for us to lead the charge. With a new-found confidence, they are working among themselves, including with China, to strengthen trade, investment and supply chain ties.

Just three weeks ago, the Regional Comprehensive Economic Partnership, or RCEP, entered into force for the ten Asian members who have ratified the agreement. The remaining five signatories are in different stages of their domestic ratification procedures but are expected to join soon. With this agreement in force, China is now part of the world's largest trading bloc covering a market of 2.2 billion people and roughly 30 percent of today's global GDP. The CPTPP recently marked its third anniversary, with eight of its eleven members having brought this high-standard agreement into force. The year ahead will be critical in determining the future shape and direction of CPTPP as members consider four pending accession applications from the United Kingdom, China, Taiwan, and Ecuador. Several other countries, including South Korea, may join the queue for membership soon.

China's CPTPP application is a potential game changer and must be taken seriously. There is no doubt that given its current trade and investment regime China would have major difficulties in adhering to many existing CPTPP rules. However, that is not a reason to dismiss the prospect of accession by the world's second largest economy. China is the number one trading partner for most countries in the region, with trade and investment flows growing steadily, and supply chains strengthening in many sectors. While some CPTPP members will try to strictly hold China to the same terms and the same high standards as any other member, others are already signaling more flexibility, believing that this would be a promising opportunity for further market-opening and reform by Beijing, while increasing their access to the large and growing Chinese market. If the United States does not step up its economic game, CPTPP accession negotiations for China could eclipse all other regional initiatives and become the most important trade negotiation in the region, with the United States sitting on the sidelines.

In addition to comprehensive trade deals like RCEP and CPTPP, our Indo-Pacific partners are also aggressively pursuing sectoral agreements, with negotiations in the digital space accelerating at an unprecedented pace. In 2020, Singapore signed its first digital agreement with Australia and in just the past six weeks, has concluded similar agreements with the United Kingdom and Korea. It is also embarking on a new digital partnership with the European Union. Singapore, New Zealand and Chile have also partnered to conclude the Digital Economy Partnership Agreement (DEPA) which is envisioned as a platform for a broader regional deal. DEPA has been gaining momentum, attracting interest from Canada and formal applications to join from South Korea and most recently China. Asian countries are also active in shaping multilateral digital rules, with Australia, Japan, and Singapore leading the ongoing plutilateral e-commerce negotiations at the WTO involving more than eighty WTO members.

ADVANCING THE INDO-PACIFIC ECONOMIC FRAMEWORK

There is no question that given the choice, most, if not all of our regional partners would prefer that the United States return to the CPTPP. However, they are coming to terms with the reality that this is unlikely to happen anytime soon, if ever. While the Biden Administration is not interested in pursuing a traditional market-opening trade agreement, it recognizes the urgency of strengthening its economic engagement in this vital region and is now developing a plan for engagement -- the Indo-Pacific Economic Framework (IPEF). So far, this initiative has been discussed in generalities, touching upon a range of topics, including the digital economy and technology, resilient supply chains, decarbonization, infrastructure, and worker standards. Agencies are now busy fleshing out the details and looking to advance the initiative in the region over the course of this year.

In my conversations with counterparts in the region, I sense a degree of skepticism that the Framework will be sufficiently substantive and receive the sustained attention by senior Administration officials to make it as impactful as a trade agreement. Moreover, I have picked up in my discussions a genuine concern that whatever specific initiatives Washington proposes under the IPEF, they will pale in comparison to China's move to join the CPTPP. At the same time, given that they want the U.S. back in the region with a substantive economic agenda, our partners are trying to keep an open mind.

The onus is now on Washington to develop a credible alternative that will simultaneously serve U.S. economic interests and attract partners with tangible benefits for shared prosperity, innovation, and inclusive growth. In my view, there is no better way to achieve these objectives than by proposing a robust and forward-leaning digital pillar as the centerpiece of the Framework.

IMPORTANCE OF A DIGITAL AGENDA

Why is digital so critical? The benefits of digitization are by no means limited to the services sector or to the big data companies. In fact, digital technologies touch all sectors of our economy impacting workers, small businesses, farmers, and consumers. For example, manufacturing relies on big data analytics, additive manufacturing, and supply chain management to modernize traditional processes and increase productivity. Likewise, farmers are utilizing digital technologies, such as artificial intelligence and the Internet of Things (IoT) to more efficiently and sustainably manage agricultural resources

Moreover, the COVID-19 pandemic has accelerated a shift to reliance on digital technologies in all aspects of our daily life, from healthcare delivery to remote work and learning. Furthermore, digital technologies have served as a lifeline for small and medium-sized enterprises (SMEs), allowing many to continue to serve their customers both domestically and internationally. There is no turning back from this tide. The International Data Corporation forecasts that 65% of global GDP will be digitized by the end of this year. To some extent, almost every industry can be considered a digital industry today.

There is nowhere in the world where the digital economy is more important than in the Indo-Pacific. Asia already accounts for half of the world's internet users and digitization of their societies is rapidly growing. The Asian Development Bank forecasts that Asia will account for 40 percent of the increase in global GDP due to digitization between 2021 and 2025. These digital trends are creating opportunities for businesses of all sizes and will shape the future economic parameters of the Indo-Pacific.

TIME IS OF THE ESSENCE

Amidst this explosion of the use and application of digital technologies, the region is not waiting for the United States to join in crafting the new rules of the road for the digital age. They are being hammered out as we speak, both bilaterally and in groupings of countries. Absent U.S. participation, these rules may work against our interests. Indeed, we are already seeing this – a case in point being the broad exception provided in the RCEP E-Commerce chapter where data obligations can essentially be ignored if a party decides for itself to do so under the guise of a self-judging public policy exception. To prevent such provisions and exceptions from becoming the regional norm and spreading to other agreements, U.S. leadership is critical.

Another crucial factor is China, which is building a very different digital future. Just last week China's State Council released an ambitious five-year plan for the digital economy, aimed at bolstering the role of digital in the Chinese economy overall, with goals related to emerging tech research, digital infrastructure, broadband access and more. China's approach to digital is marked by laws and regulations requiring data localization, restrictions on cross-border data flows, and policies that favor and promote domestic digital champions. But the digital economy is not bound by geographic borders, so no matter how domestic the focus, China's efforts are inherently international in their implications.

Indeed, the State Council's plan is explicitly framed as "a key force in reorganizing global resources, reshaping the global economic structure, and altering the global competitive landscape." It lays out Beijing's intentions to pursue digital economy partnerships with ASEAN and the EU, as well as to become more active on digital matters in international organizations, including the WTO. China's goal is to create a favorable international environment for its own priorities related to cross-border data flow restrictions, data privacy, market access and more. And China's vision for the use of digital technologies includes worrying efforts to manage access to information, constrain dissent, and carry out monitoring and repression of certain populations. The United States must work with like-minded partners to provide an affirmative alternative to this approach that advances democratic norms and values, such as transparency openness, and fairness.

At the same time, protectionist digital measures have been the rise. USTR's 2021 National Trade Estimate (NTE) report highlights a range of recent policy and regulatory actions undertaken by Asian countries, including data localization requirements, discriminatory practices affecting trade in digital products, and restrictions on the provision of digital services. Experience has shown that it is always harder to reverse course once policies become enshrined in domestic legal and regulatory frameworks. We have the opportunity now to help write the rules to discipline such measures, which ultimately hurt our businesses and workers.

DEVELOPING AN INDO-PACIFIC DIGITAL ECONOMY AGREEMENT

There are a number of options on how best to pursue a regional digital economy strategy. For example, the United States could seek membership in the DEPA or alternatively could ask partners to sign on to the U.S.-Japan Digital Agreement. However, I believe that the United States would be best served by shaping a new paradigm by lifting the most meaningful, inclusive, and forward-looking elements from existing agreements, while adding new features to better ensure that the outcomes benefit all of our citizens, and don't accrue disproportionately to large companies. In developing such an approach, extensive consultations with Congress and stakeholders, including labor, consumer groups, and NGOs, are critical. But in pursuing these conversations, it's important to be mindful of which suggestions might be more appropriately addressed by the implementation of domestic measures rather than in an international pact.

In my view, there are five core areas for a proposed digital economy agreement:

First, the *values and principles* underlying the overall agreement should be included up-front. The October 2021 G-7 Digital Trade Principles provide some useful and relevant ideas, including the importance of an open, free and secure internet; the need for digital markets to be competitive, transparent, fair and accessible; the view of digital trade as a tool to support jobs, raise living standards and respond to needs for workers, innovators, and consumers; and a rejection of digital protectionism.

Second, certain provisions of *existing digital trade agreements* should be featured. In this regard, the CPTPP, U.S.-Japan Digital Trade Agreement, and the digital chapter of the USMCA can serve as important models. Among the provisions to be included would be free flow of data across borders; prohibition on localization requirements for computing facilities; and a ban on requirements to turn over one's source code, algorithms, or related IPR. These provisions would promote innovation and economic growth while ensuring that U.S. products and services, which are among the most competitive in the world, are treated fairly in foreign markets.

Third, new or expanded provisions should be added to *address concerns of workers and consumers*, including those that promote digital inclusiveness; strengthen consumer confidence and trust; and protect personal information. In addition, a venue for discussing the development of needed workforce skills for the digital world, a challenge facing all economies, would be beneficial.

Fourth, such an agreement should focus on *promoting those digital tools that enhance the ability of SMEs to market, sell, and receive payments for their products and services*. It should include provisions to facilitate trade by enabling paperless trading, e-invoicing and e-bills of lading.

Fifth, a digital economy pact should be designed to *take on challenges presented by new trends and technologies*. Given the dynamic nature of this sector, an agreement cannot be static if it is to remain relevant. This can start with "soft" provisions featuring exchanges on such trends, including the emergence and application of artificial intelligence.

POTENTIAL PARTNERS FOR A DIGITAL ECONOMY AGREEMENT

Finally, to be impactful, an agreement should cast a wide net for potential membership while still seeking to keep standards high. While it may be tempting to move forward with only those countries that already share our values and interests in the digital space, this is not the optimal approach. Instead, Washington should try to be as inclusive as possible as it contends with competing views for the digital future so that our vision is well-positioned to prevail.

In particular, the U.S. should make special efforts to encourage ASEAN member countries to get on board. With a large and youthful population, Southeast Asia is projected to grow over 5.5% annually to become the fourth largest economy in the world by the end of this decade. ASEAN's digital economy is a key driver of this rapid growth with over 400 million internet users and an internet economy that is projected to reach $1 trillion by 2030. ASEAN also hosts a vibrant ecosystem of digital companies with many opportunities for U.S. businesses. Governments in ASEAN are prioritizing digital development as well, with an ASEAN E-Commerce Agreement entering into force at the end of last year.

A more inclusive digital agreement may require offering some flexibilities to attract members. DEPA can serve as a possible model. It features a “modular” structure with countries having the option of joining the agreement in its entirety or just signing up for certain parts as a first step. Adopting some version of this approach is worth considering.

CONCLUSION

The time is now for the United States to demonstrate its interest and resolve in pursuing strong and enduring economic engagement in the Indo-Pacific region. Reasserting U.S. economic leadership won’t be easy given the recent dramatic changes in the regional economic landscape. Our partners have developed the confidence to move forward without us and are busily working among themselves to set regional rules, norms and standards, irrespective of our participation. That said, a bold, meaningful and inclusive economic framework with a strong digital component could a go a long way in getting us back to the regional rule-making arena.

As was so well stated in a recent letter by the Chairman and Ranking Member and signed by a number of members of this Subcommittee, “a digital trade agreement with like-minded countries in the Indo-Pacific region presents a unique opportunity to expand American economic leadership in the region and improve lives” but “this window of opportunity will not remain open indefinitely.” I could not agree more. We need to move now to position the United States as a regional leader on these matters.

Thank you.